IN THE

Supreme Court of the United States

October Term 1975

No. 75-1652

MARION STONE,

Petitioner,

vs.

UNITED STATES OF AMERICA,

Respondent.

PETITION FOR A WRIT OF CERTIORARI
To the United States Court of Appeals
For the Eighth Circuit

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The petitioner, Marion Stone, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Eighth Circuit entered in this proceeding on March 23, 1976.

OPINION BELOW

The opinion of the Court of Appeals, and order denying rehearing, not yet reported, appear in the appendix hereto.

JURISDICTION

The judgment of the Court of Appeals for the Eighth Circuit was entered on March 23, 1976; a timely petition

for rehearing was denied on April 13, 1976, and this petition for certiorari was filed within thirty days of that date. This Court's jurisdiction is invoked under 28 U.S.C. §1254(1).

QUESTIONS PRESENTED

Whether a tax evasion conviction is valid where the Government's opening net worth figure failed to include some thirty automobiles which several government witnesses knew to be in the taxpayer's possession?

Whether in a tax evasion prosecution the government may introduce evidence that ten years before the years on trial the taxpayer's returns were referred for fraud investigation?

CONSTITUTIONAL PROVISIONS INVOLVED

Amendment V.

No person shall be held to answer for a capital, or otherwise infamous crime, unless on a presentment or indictment of a Grand Jury, except in cases arising in the land or naval forces, or in the Militia, when in actual service in time of War or public danger; nor shall any person be subject for the same offence to be twice put in jeopardy of life or limb; nor shall be compelled in any criminal case to be a witness against himself, nor be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use, without just compensation.

STATUTORY PROVISIONS INVOLVED

18 U.S.C. §7201. Attempt to evade or defeat tax

Any person who willfully attempts in any manner to evade or defeat any tax imposed by this title or the payment thereof shall, in addition to other penalties provided by law, be guilty of a felony and, upon conviction thereof, shall be fined not more than $10,000, or imprisoned not more than 5 years, or both, together with the costs of prosecution. Aug. 16, 1954, c. 736, 68A Stat. 851.

STATEMENT OF THE CASE

Petitioner Marion Stone was indicted for willfully filing false tax returns for the years 1968 and 1969, (in violation of 26 U.S.C. §7201), convicted after jury trial, and sentenced to three years incarceration with 33 months suspended, and a $10,000 fine.

The Government prosecuted on a net worth theory of proof and it is petitioner's primary contention here, as it was at trial and in the Court of Appeals, that the evidence failed sufficiently to establish an opening net worth with reasonable certainty.

Mr. Stone had several sources of income during the years in question—real estate, a bar, and a used car dealership—but it is only the inventory in the automobile business at the beginning of 1969 which is in issue here. The government's opening net worth ($67,328.81), Government Exhibit W95-11; Transcript, Volume V. pp. 80 et seq., included some $7,938.91 for some eight automobiles in inventory, based upon "floor plan" and "car check report" information obtained from a company where Mr. Stone financed some of his automobiles. (T., Vol II, pp.

185 et seq.). There was testimony that Stone told an IRS agent that all of his cars were "floor planned" at this time, (T., Vol. I, p. 78), but his records were not good, and the attorney who did his tax returns at that time testified that he did not think Stone understood or appreciated the importance of the details involved. (T., Vol. II, pp. 214-216).

The man who had made the "car check report" at the end of 1967 was one Leroy Brills, who had been an Industrial Credit employee at that time. (T., Vol. VI, p. 24). The Government did not call him as a witness, although someone from the United States Attorney's office had spoken to him as recently as the Monday before his testimony. The defense did call Mr. Brills, and he described that conversation thus:

> A. I got a call from a person representing the government prosecutor's office. I don't recall the name.
> Q. Okay. What was said to you?
> A. They asked me if I had formerly been employed by Industrial Credit and if I had done a floor plan check of Mr. Stone's inventory prior to the time I left, and I said yes. And they informed me that—I asked them what was the nature of this? They said, I might be called for a witness in the trial. And they further asked me if the cars that we had made up the total inventory that was on hand when I checked them, and I said, no, there was a lot more cars. And they asked me if I knew where these cars came from, what was the source, whose cars they were or where they came from, and I said I do not know. I had no idea.
> Q. Okay. The manner in which you were asked about how many cars were there in addition to these eight, did the person just say, can you tell me the number, or did they suggest an answer to you?

> A. No. They just said this was all the cars that were on hand at that time, or was this all.
> Q. Okay.
> A. And I said no, there were plenty more. There were a lot of cars on hand, and I did not know where the source, where they came from.
> Q. And the Government has not contacted you since, correct?
> A. No. I said I would be available but they said it probably would be unlikely I would be called. So that's the last I heard. (T., Vol. VI, pp. 30-31)

He testified he had personally prepared the floor plan car check report (Government Exhibit W17-18), by examining the automobiles on December 28, 1967, and had some difficulty doing so because the "very large building," (a converted theatre, apparently), was so "full of cars" that it was necessary to move some of the vehicles simply to be able to open their doors and check serial numbers. Mr. Brills testified there were "thirty or more" automobiles *in addition to* the eight on the "floor plan." Moreover, these thirty or more vehicles which were not included in the floor plan (or in the Government's opening net worth) were better and more valuable than those in the floor plan. (T., Vol. VI, pp. 26-33).

A Government witness had already testified that Stone had vehicles at earlier times beyond those on a floor plan of his finance company and he estimated that the building would hold twenty-five or thirty cars. (T., Vol. II, pp. 196-197). Another Government witness, who bought a car from Stone and was frequently at the Auto Mart in late 1967, testified that the building contained about twenty-five or thirty cars at that time, and that there were other,

older cars in a lot across the street: thirty-five to forty all together. (T., Vol. III, pp. 36-37).

Finally another Government witness, who had been at Stone's often and particularly in December, 1967, testified that there were many vehicles there, his estimate being twenty to twenty-five. (T., Vol. III, pp. 74-75).

The Government's evidence showed increases in net worth of $19,487.99 during 1968, and $40,416.37 in 1969, (T., Vol. V, pp. 83 et seq.), including only the eight "floor planned" automobiles valued at about $8,000, and not taking into account the additional thirty or so vehicles which were the subject of the aforementioned testimony.

Stone did not testify; the Court of Appeals held that he remained silent "at his peril," that the opening net worth was established with reasonable certainty.

Finally, an IRS agent was permitted to testify over objection that in earlier years, 1958 and 1959, Stone's tax returns were referred for fraud investigation. (T., Vol. I, pp. 7-20). The Court of Appeals held that this question and answer were "preliminary" and, if error, harmless.

REASONS FOR GRANTING THE WRIT

I.

In *Holland* v. *United States*, 348 U.S. 121 (1954), this Court gave detailed attention to the net worth method of tax prosecution and took note of its dangers:

> Trial courts should approach these cases in the full relization that the taxpayer may be ensnared in a system which, though difficult for the prosecution to utilize, is equally hard for the defendant to refute. . . . Appellate courts should review the cases, bearing constantly in mind the difficulties that arise when circumstantial evidence as to guilt is the chief weapon of a method that is itself only an approximation. 348 U.S. at 129.

Turning then to the requirement of a definite opening net worth, the *Holland* Court said:

> We agree with petitioners that an essential condition in cases of this type is the establishment, with reasonable certainty, of an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets. The importance of accuracy in this figure is immediately apparent, as the correctness of the result depends entirely upon the inclusion in this sum of all assets on hand at the outset 348 U.S. at 132.

In their investigation to establish this crucial opening net worth, as in other aspects of such circumstantial cases, the Government is required to be thorough if not exhaustive in following all available investigative leads:

> When the Government rests its case solely on the approximations and circumstantial inferences of a net worth computation, the cogency of its proof depends upon its effective negation of reasonable explanations by the taxpayer inconsistent with guilt. Such refutation might fail when the Government does not track down relevant leads furnished by the taxpayer—leads reasonably susceptible of being checked, which, if true, would establish the taxpayer's innocence. When the Government fails to show an investigation into the validity of such leads, the trial judge may consider them as true and the Government's case insufficient to go to the jury. 348 U.S. at 135-136.

Despite these admonitions, despite the unrebutted evidence of some thirty automobiles excluded from the opening net worth, and despite the fact that the government's own witnesses, as well as the witness (Brills) who informed the Government of this large item of inventory but whom the Government did not call as a witness, the Court of Appeals found net worth sufficiently established, found that the Government had not failed to pursue a relevant lead, and found that Petitioner's decision not to testify in his own behalf could be held against him. The opinion thus stands in direct conflict not only with the letter and spirit of *Holland*, but with the right to Due Process of Law and the Privilege against Self-Incrimination.

First, the opening net worth was clearly not established with reasonable certainty since it failed to include some thirty automobiles.

Second, the Government's own witnesses had knowledge of these automobiles, and it thus is equally clear the Government failed to pursue a relevant lead.

Third, the Court of Appeals failed to apply the cautious scrutiny of the record required by *Holland* in net worth cases.

And, fourth, the Court of Appeals penalized petitioner for his silence in a manner not intended by *Holland* or tolerable under the Fifth Amendment.

It is true that language suggesting that the taxpayer remained silent at his peril is found in the *Holland* opinion, 348 U.S. at 138-139, but it cannot be applied here for in *Holland* the Court was concerned only not to require the Government to negate any possible *source of income* once the net worth was reasonably established. The *Holland* Court added:

> The practical disadvantages to the taxpayer are lessened by the pressures on the Government to check and negate relevant leads. 348 U.S. at 139.

In *Holland* there was no unchecked lead comparable to the omitted vehicles in the present case; the *Holland* taxpayer's silence was as to the source of income, not as to the existence of an asset actually known to the Government and omitted from its calculations, as here.

The opinion below thus penalizes (and suggests that the jury properly penalized) this taxpayer for remaining silent at trial where the Government's own evidence supplied the fact about which he remained silent: the fact of a substantial asset not included in the net worth. Therefore, unlike *Holland* there is no danger here of requiring the Government to negate all conjectural sources of income; reversal requires only what *Holland* requires: (1) inclusion of all known assets in the opening net worth, and (2) investigation of all known leads as to possible assets. The opinion below, to the contrary, permits the Government to exclude assets and ignore leads, and thus directly shifts the burdent of proof to the accused.

Because of the peculiar dangers inherent in net worth prosecutions recognized in the *Holland* opinion, because of the disregard by the court below of the precautions required to protect against these dangers, and because of the continuing importance and prevalence of tax evasion prosecutions, this Court should review the opinion below in order to clarify and reaffirm the teaching of *Holland*.

II.

Over repeated objections a Government agent was permitted to testify that he had referred petitioner Stone's tax

returns for fraud investigation some ten years before the years on trial:

> Q. What were the results of your audit after examining all the records and the returns and the interview that you had with third parties and Mr. Stone?
>
> MR. FRIEDBERG: [Defense Counsel] Your Honor, the same objection based on improper foundation.
>
> THE COURT: You may answer.
>
> THE WITNESS: Well, I never completed the audit of those returns. I examined the information that was available to me at that point and based on the—my findings—I referred the case to the intelligence division as a potential fraud case.
>
> BY MR. PAAR: [Government Counsel]
>
> Q. Why did you do that?
>
> A. Well, I found that—
>
> MR. FRIEDBERG: Objection, irrelevant, Your Honor.
>
> . . . . .
>
> THE COURT: You may answer.
>
> THE WITNESS: Well, when Mr. Stone came in, he indicated that he had one bank account, one checking account and no savings accounts, and during the course of my examination I discovered that he had another checking account and that he did have a savings account, and I had also discovered that he had sold a number of automobiles that were not listed on the tax return, and based on these findings, I referred the case to the intelligence division.
>
> MR. FRIEDBERG: Your Honor, I object and ask the answer be stricken as without proper foundation.
>
> THE COURT: The answer may stand. Next question.
>
> (T., Vol. I, pp. 7-9)

The testimony could have had no other effect except to inform the jury that Agent Hanson believed Mr. Stone had

evaded taxes in 1958 and 1959, and to invite them to believe that therefore he must have evaded taxes willfully in 1968 and 1969.

In *United States* v. *Logan*, 441 F. 2d 230, 232 (6th Cir. 1969), a tax evasion conviction was reversed because of the prejudicial effect of evidence that the accused had failed to file returns in earlier years, (from six to fifteen years earlier), despite a cautionary instruction.

> The Government was correct in conceding that Appellant's alleged failure to file federal income tax returns in a period far removed from the indictment years had nothing to do with the issues in the case. The likely effect of such evidence was to prejudice the jury against Appellant rather than to prove that he committed the crimes named in the indictment. We do not believe, moreover, that the Court's instruction to the jury to disregard this evidence was sufficient to take it out of the case. Evidence of prior wrongdoing is "of a sort most likely to remain firmly lodged in the memory of the jury and to excite a prejudice which would preclude a fair and dispassionate consideration of the [case]." Quercia v. United States, 289 U.S. 466, 53 S. Ct. 698, 77 L.Ed. 1321 (1933).

In the present case the prejudice was if anything greater, since the evidence was nothing less than a law enforcement officer's opinion of guilt. The opinion below is thus in conflict with the law in the Sixth Circuit. And on this issure, too, the court below disregarded the teaching and spirit of *Holland* that caution against prejudice is especially important in net worth cases. For this reason as well the writ should issue to review the opinion of the Court of Appeals.

CONCLUSION

For the foregoing reasons, Petitioner prays that a writ of certiorari issue to review the judgment and opinion of the Eighth Circuit.

Respectfully submitted,

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APPENDIX

United States Court of Appeals
For The Eighth Circuit

No. 75-1366

United States of America,

Appellee,

v.

Marion Stone,

Appellant.

Appeal from the United States District Court for the District of Minnesota.

Submitted: December 9, 1975.
Filed: March 23, 1976.

Before LAY, BRIGHT, and HENLEY, Circuit Judges.

BRIGHT, Circuit Judge.

The United States indicted appellant-Marion N. Stone for willfully filing fraudulent tax returns for calendar years 1968 (count I) and 1969 (count II). A jury found Stone guilty on both counts and the district court imposed a general sentence of imprisonment for a period of three years with 33 months suspended. The district court also imposed

a fine of $10,000, and provided as a condition of probation that Stone should actively cooperate with the United States in the settlement of his civil tax liabilities. Stone brings this appeal and we affirm the conviction.

Stone's business enterprises included a recreational parlour known as the "Celebrity Lounge," the operation of a used car business known as "Stone's Auto Mart," and the sale and rental of real estate properties. Since Stone had not kept adequate records of his business transactions for the years in question nor for prior years,[1] the Government proceeded to prove its case by the net worth method. Stone had reported his taxable income for the year 1968 at $12,-951. The Government calculated that his net worth had increased in that year over $25,000, and that his corrected taxable income amounted to $30,243. For the calendar year 1969, Stone reported income of $14,390, but the Government calculated a net worth increase of more than 42,000 in 1969, and computed Stone's taxable income at $51, 910. The Government determined that Stone understated his income for the year 1968 by $17,292 and for the year 1969 by $37,519.

Stone seeks to overturn his conviction on the following grounds:

1) That the evidence was insufficient to sustain the conviction under the net worth method because the open-

[1]The evidence disclosed that Stone's problems with the Internal Revenue Service began in 1960 when his 1958 and 1959 federal tax returns were audited. The audit showed substantial tax deficiencies for both years.

In 1965, the Internal Revenue Service audited Stone's 1962 tax return and determined that discrepancies existed. During these years, Stone did not maintain adequate records and the Government was required to resort to the net worth method to ascertain Stone's taxable income.

ing net worth statement for the calendar years involved failed to include a number of used automobiles in the inventory of Stone's Auto Mart;

2) that the evidence was insufficient to prove a willful violation of 26 U.S.C. 7201; and

3) that the trial court committed prejudicial error in permitting an Internal Revenue Service agent to testify that Stone's 1958 and 1959 tax returns had been referred to the Intelligence Division of the Internal Revenue Service for possible fraud prosecution.

We examine these contentions.

I. Net Worth Calculation.

In utilizing the "net worth" method of proof to establish Stone's tax evasion, the Government included in Stone's opening net worth for calendar year 1968 the sum of approximately $8,000, representing Stone's inventory of used cars on hand at his "Auto Mart." This calculation was based on Stone's statement in 1972 to an Internal Revenue Service agent that the only cars he had in inventory at the end of years 1967, 1968, and 1969, were cars that were "floor planned."[2] Stone told the Internal Revenue Service personnel that during the course of his business he had obtained automobile loans from Industrial Credit, Liberty State Bank, Commercial State Bank, and Bambles Continental State Bank. After following these leads, the Internal Revenue determined that at the end of 1967, eight cars had been floor planned with Industrial Credit and that the value of this inventory to Stone amounted to approximately

[2]In this case, the floor planned" or financed vehicles were those in inventory by reason of repossessions from defaulting purchasers.

$8,000. That inventory figure was verified by testimony of a witness formerly employed by Industrial Credit, who identified records establishing a physical count and value of the floor-planned vehicles on December 28, 1967. The Government checked with other finance companies but was unable to locate any additional floor plans for 1967-69. Accordingly, the Government used the approximate $8,000 inventory figure of the Industrial Credit floor plan as the opening automobile inventory of Stone's Auto Mart for calendar year 1968. As noted, this figure was based on Stone's own statement that all of his cars at year end were floor planned and the fact that the Government could only locate the Industrial Credit floor plan. This $8,000 calculation with other items not in question made up the opening net worth of the taxpayer for 1968, which totalled approximately $67,000.

Stone did not testify at the trial. However, he produced evidence from other witnesses, who stated that they saw more than the eight floor-planned automobiles at Stone's Auto Mart warehouse. In particular, Leroy Brills, a former employee of Industrial Credit and the person who counted the automobiles floor-planned to Industrial Credit, testified that on December 28, 1967, he verified the eight automobiles financed to Industrial Credit and recalled seeing 30 or more additional cars in the automobile warehouse. He did not know, however, whether Stone actually owned those additional automobiles. Other witnesses testified that there were many more than eight cars at the warehouse; however, no one knew who owned the cars.[3]

[3]The Internal Revenue attempted to ascertain Stone's ownership of the automobiles through Minnesota state records, but these records had been destroyed. Stone disclosed no ownership records for additional automobiles.

In considering the appellant's contention that the evidence was insufficient to sustain a conviction on the net worth method of calculating taxpayer's income, we are mindful of the Supreme Court's admonition in Holland v. United States, 348 U.S. 121 (1954), that the Government is required to establish "with reasonable certainty, * * * an opening net worth, to serve as a starting point from which to calculate future increases in the taxpayer's assets [and that] * * * the correctness of the result depends entirely upon the inclusion in this [net worth] sum of all assets on hand at the outset." Id. at 132.

The Holland court also noted the duty of the Government to investigate leads furnished by the taxpayer:

> When the Government rests its case solely on the approximations and circumstantial inferences of a net worth computation, the cogency of its proof depends upon its effective negation of reasonable explanations by the taxpayer inconsistent with guilt. Such refutation might fail when the Government does not track down relevant leads furnished by the taxpayer—leads reasonably susceptible of being checked, which, if true, would establish the taxpayer's innocence. [Id. at 135-36.]

Here, Stone did not furnish the Government with any record of an actual automobile inventory. The Government reconstructed this inventory based upon the best information available. Stone indicated that all of his inventory was floor planned and he did not inform the Government of any other floor plans besides the Industrial Credit plan. Stone at the trial produced some evidence showing the physical presence of other vehicles in the automobile ware-

house, but no evidence that Stone himself owned those vehicles. The record shows that the Government had sought information on these other cars. It checked other finance companies in search of other floor plans and attempted to check Minnesota state records to ascertain automobiles owned by Stone. As the Holland Court noted:

> [W]here relevant leads [from the taxpayer] are not forthcoming, the Government is not required to negate every possible source of nontaxable income, a matter peculiarly within the knowledge of the defendant. [Id. at 138-39.]

Once the Government establishes the opening net worth with "reasonable certainty," as was the case here, defendant-Stone, who remained silent, did so at his peril. Id. Accordingly, we reject the taxpayer's contention that the prosecution failed to establish an opening net worth with "reasonable certainty."

II. Willfulness.

Stone contends that the evidence was insufficient to show willfulness. We disagree. Stone's returns had been audited twice before the audit and prosecution in this case. He was well aware of his obligation to keep adequare records concerning his income. In statements to IRS agents, Stone admitted that he kept most of his records in his head. There was evidence that some of his records had been accidentally destroyed in 1967, but no adequate explanation of his failure to keep adequate records for subsequent years, including the years here in question. Indeed, an IRS agent related that Stone told him in 1972 that "his car business was a mess and that he could not keep records and only

he and God could figure out what the status of his car business was." The Bovernment produced adequate evidence of Stone's willful failure to account for his income during the years here in question. The issue of willfulness properly went to the jury.

III. Evidence Properly Admited

Agent Robert J. Hanson of the IRS testified over objection that in auditing Stone's earlier returns for the calendar years 1958 and 1959, he referred Stone's case to the Intelligence Division as a potential fraud case.

The dialogue between court and counsel indicated that the court admitted that evidence solely to show that the investigation that year had been referred to the division of the Internal Revenue Service which has responsibility for investigating fraud cases.

Subsequently in the course of the trial the Government called Revenue Agent Howard G. Lorch, who testified that he worked with an Intelligence agent in the further investigation of Mr. Stone's 1958 and 1959 tax returns. An audit report was prepared in which the taxpayer agreed with the findings of the Internal Revenue agents that Stone owed additional income taxes.

The record reveals that the answer by Agent Hanson to the objected-to question was preliminary and furnished a foundation for introduction of evidence of the subsequent formal audit made of the taxpayer's 1958 and 1959 tax liabilities. Agent Lorch made clear on cross-examination that the Intelligence Division withdrew from the case and that no criminal liability ever attached to the taxpayer's reporting of his 1958 and 1959 tax liability.

Under the circumstances, if there were error in a revenue

agent mentioning that the 1958 and 1959 returns had been referred to the Intelligence Division as a potential fraud case, that error cannot be deemed prejudicial in the context of the explanation furnished by the next witness.

Finding no prejudicial error in the proceedings, we affirm the conviction.

A true copy.

Attest:

CLERK, U.S. COURT OF APPEALS, EIGHTH CIRCUIT.

United States Court of Appeals
For The Eighth Circuit

75-1366

The United States,

Appellee,

vs.

Marion N. Stone,

Appellant.

Appeal from the United States District Court for the District of Minnesota

September Term, 1975

The Court having considered petition for rehearing en banc filed by counsel for appellant and, being fully advised in the premises, it is ordered that the petition for rehearing en banc be, and it is hereby, denied.

Considering the petition for rehearing en banc as a petition for rehearing, it is ordered that the petition for rehearing also be, and it is hereby, denied.

April 13, 1976.